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Department of the Treasury

Washington, DC 20224

[Third Party Communication:

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:TEGE:EO2

PLR-137765-08

Date:

December 09, 2008

LEGEND

Trust =

State =

State Statute =

Plans =

State Retirement System =

Dear :

This is in reply to your letter dated August 27, 2008, requesting rulings that the income of Trust is excluded from gross income under § 115(1) of the Internal Revenue Code and that Trust is not required to file a federal income tax return.

FACTS

Trust was created pursuant to State Statute to help certain public employers fund hospital and medical benefits for their retired employees, spouses and dependents under Plans. Plans provide benefits through a self-insurance arrangement. The participating employers and the participating retirees each contribute to the cost of the health coverage. Benefits provided pursuant to Plans include medical and prescription drug benefits. Only an employer that is a state, a political subdivision of a state or an entity the income of which is excluded from gross income under section 115 of the Code can become a participating employer in Plans.

Trust is governed by the same board of nine trustees that governs the State Retirement System. Five trustees are selected by and from participating employees and retired employees, three are selected by the governor and one is a state official.

Trust's income is derived from employer contributions and investment income. Trust's income is used solely for retiree benefits and trust expenses. Plans do not permit any benefits to be paid by pre-tax salary reduction. No cash-out of amounts paid for Plan benefits and no conversion of sick or vacation days to post-retirement medical benefits is permitted. Domestic partners may be beneficiaries under Plans. Trust represents that, in administering Plans, it will make reasonable efforts to identify individuals who do not qualify as a spouse or as dependents under §152 of the Internal Revenue Code of participating retired employees in Plans and will, in accordance with applicable tax law, include in the income of retirees the value of the participating employers portion of coverage for such individuals.

The trustees may amend or terminate Trust. Upon termination, the trustees will distribute the remaining assets of Trust solely for the purpose of assisting in the payment of health benefits for retirees and related administrative expenses. In no event will the assets of Trust will be distributed to an entity that is not a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under § 115 of the Internal Revenue Code.

LAW AND ANALYSIS

Section 115

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to

extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides health benefits to retired employees of its participating employers. All participating employers are required to be a state, a political subdivisions of a state or an entity the income of which is excluded from gross income under § 115(1) of the Code. Providing health benefits to current and retired government employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to its participating employers, all of whom are political subdivisions or entities the income of which is excluded from gross income under § 115(1) of the Code. Upon the dissolution of Trust the use of its remaining funds to provide health benefits for retirees satisfies an obligation the participating employers have assumed with respect to providing health benefits to their employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Based on the information and representations submitted by Trust, we hold that, as of the date the amendments are adopted, the income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.

Section 6012

Section 6012(a)(2) and Treas. Reg. § 1.6012-2(a)(1) of the regulations provide, in part, that every corporation, as defined in § 7701(a)(3), subject to taxation under subtitle A is required to file an income tax return regardless of whether it has taxable income or regardless of the amount of its gross income.

Section 6012(a)(4) provides that every trust having for the taxable year any taxable income or having gross income of \$600 or over, regardless of the amount of taxable income, must file an annual income tax return. Section 7701(a) and § 301.7701-4 of the regulations define trust for purposes of § 6012.

If Trust is classified as a trust for federal income tax purposes, no annual income tax return is required to be filed by Trust pursuant to § 6012(a)(4) since any income realized by Trust is excluded from gross income under § 115(1). However, if Trust is a corporation, as defined in § 7701(a) (3), it will be required to file an income tax return pursuant to § 6012(a)(2).

No opinion is expressed on the classification of Trust as a trust or corporation for federal tax purposes. No opinion is expressed concerning the federal tax consequences of the Trust under any other provision of the Code other than those specifically cited above. In particular, no representation is made that contributions to the Plans or payments to employees, former employees, retirees, spouses or beneficiaries will be tax-free. This ruling concerns only the federal tax treatment of the Trust's income. It may not be cited or relied upon by the State Retirement System whatsoever as precedent concerning any matter relating to the Plans. In particular, this ruling has no effect on whether contributions to the Plans or payments from the Plans (including reimbursement of medical expenses) are excludable from the gross income of employees, former employees or retirees, under the Internal Revenue Code. The federal income tax consequences to employees, former employees and retirees depend on the terms and operation of the Plans.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your representative.

Sincerely,

Sylvia F. Hunt
Assistant Chief, Exempt Organizations
Branch 2
Division Counsel/Associate Chief
Counsel (Tax Exempt and Government
Entities)

Enclosures:

Copy of this letter
Copy for § 6110 purposes